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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

NO. 77-1652

FEDERAL ENERGY REGULATORY COMMISION,
Petitioner,
v.
SHELL OIL COMPANY, ET AL.,
Respondents.

NO. 77-1654

CONSUMER FEDERATION OF AMERICA,
ENERGY POLICY TASK FORCE,
Petitioner,
v.
FEDERAL ENERGY REGULATORY COMMISION,
Respondent.

BRIEF OF RESPONDENT PRODUCERS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI

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June 19, 1978

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Shell Oil Company, *et al.*[1] (herein called "Producers") who were petitioners or intervenors in the case below

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1. A complete list of the Producers joining herein is contained on the inside cover of this Brief.

respectfully submit their Brief in Opposition to the petitions filed in Case Nos. 77-1652 and 77-1654 for writs of certiorari to review the opinion and judgment of the United States Court of Appeals for the Fifth Circuit entered in this case on January 20, 1978.[2]

STATEMENT OF POSITION

The Court of Appeals correctly interpreted Section 1 (b) of the Natural Gas Act (15 U.S.C. § 717(b) 1970)[3] as denying the Commission's jurisdiction to regulate the production activity, as distinguished from its authority to regulate a sale in interstate commerce for resale. Such production activity was, at the time the Natural Gas Act was passed, and still is, extensively regulated by state conservation agencies. Such operations are also under the constant scrutiny of the lessor in the oil and gas lease under which the producer operates, who has extensive rights under state law to insure these operations are conducted in a diligent manner. For these reasons, Congress in enacting the Natural Gas Act and this Court in construing the producer's obligations under that Act, have always drawn a careful distinction between regulation of the production activity and regulation of the act of selling gas in interstate commerce for resale. The Commission cannot, as it sought to do in the Order below, obliterate that distinction by imposing certificate conditions under Section 7(e) of the Act, or by broadening its authority over abandonments under Section 7(b) of the Act.

2. The Court of Appeals' opinion is attached as Appendix A to the Petition in Case Nos. 77-1652, *et al.* References to that opinion will refer to the pages in that Appendix.

3. See Appendix D to the Petition in Case No. 77-1652.

STATEMENT OF FACTS

This proceeding was founded on two basic misconceptions of fact and law. The first of these is that the gas shortage now prevalent in the United States is the result of withholding from the market of natural gas supplies by producers in an attempt to obtain price relief from the Commission or to induce Congress to deregulate gas prices. These charges have been extensively investigated not only by the Commission but by Congressional Committees, the Federal Trade Commission, and the Department of Interior, and have been discredited. In oral argument before the Court of Appeals, the Commission's counsel agreed that the Commission had found no evidence of gas withholding by producers.[4] The real cause of the gas shortage is the decline in deliverability in the older producing fields which is a normal incident of a depletion of those fields, coupled with the inability of the producing industry, acting under the price constraints imposed by the Commission under the Natural Gas Act, to find new gas supplies at a rate equivalent to the depletion rate of the older fields.

While conceding that there was no evidence that producers were actually withholding gas supplies, both petitioners alleged that the producers have both the motive and the opportunity to do so unless restrained by Commission regulation. Neither of these allegations is correct. The alleged motive, to obtain some possible higher price at a later date, is more than offset by the risk that if the producer does not act diligently he may never recover the gas under his lease at all. Gas moves freely through the reservoir rock, and is not confined by lease

4. Petition, Appendix A, p. 3a.

boundaries. If one producer shuts in his lease, his gas will be produced by the offsetting lessee and lost to him forever. Thus, there could be no possible motive for a producer to deny himself not only a return on his investment but a recovery of his costs by deferring that return to some nebulous point in the future.

Nor does the producer have the opportunity to be indolent or careless in his development and production operations, as the Commission would imply (pp. 11 and 15), absent Commission regulation. State conservation laws etxensively regulate the production and development of oil and gas reservoirs.[5] The validity of these laws was upheld by this Court in *Champlin Refining Co. v. Corporation Commission*, 286 U.S. 210 (1931). In addition to the state conservation laws, the lessor of the oil and gas lease has extensive legal rights to insist that its lessee operate in a diligent manner. The penalty for failure can be loss of the lease and extensive monetary damages.[6] In the offshore area, where the lessee is the Bureau of Land Management of the Department of Interior under the Outer Continental Shelf Lands Act (67 Stat. 462), the Department's Regulations provide specifically for the exercise of diligence by the lessee (43 C.F.R. §§ 3307.3-2, 3307.3-4.

The second major misconception, which formed the basis of this proceeding below and petitioners' argu-

5. See *e.g.*, 52 Okla. Stat. § 274 (1971); N.M. Stat. Ann. 65-3-13, *et seq.*, (1953); Vernon's Tex. Civ. Stat. Ann. art. 6049 C, *et seq.* (1962); Kan. Stat. Ann. 55-701, *et seq.*; West's La. Stat. Ann. R.S. 30:4, *et seq.* and Ark. Stat. § 55-109, et seq.

6. Summers, *Oil and Gas Law*, §§ 454-472, pp. 149-392 and Williams and Meyers, *Oil and Gas Law*, Vol. 5, § 815, pp. 75-6 and § 825, pp. 153-76.

ments here, is the concept that when a producer entered into a gas sales agreement to sell the gas from a given field or reservoir, and obtained a certificate from the Commission authorizing such sale, that the producer somehow guaranteed that the reservoir would continue to produce at its initial rate forever, or at least at some predictable and measureable rate of decline. This assumption is simply not in accordance with the facts in a normal gas field. Gas moves through porous spaces in the reservoir rock in response to its pressure, and that of adjacent liquids, in complex and unpredictable ways. Projections of this performance are necessarily imprecise and frequently in error, and subject to continual change as the production reservoir continues. The producer does not agree or guarantee what the deliverability rate of a reservoir will be at the time he signs his contract, or applies for his certificate.[7]

In the Order here under review, the Commission recognized that the typical contract or certificate did not contain any specific delivery obligations or guarantees, but insisted that there was an implied obligation on the

7. Although the Commission has now conceded the point, Consumer Federation of America ("CFA") continues to argue that the producer's certificate contains a delivery obligation. Failing to find any such obligation in either the contract or the express language of the certificate, CFA seeks to imply one from the material filed with the producer's application for the certificate (18 C.F.R. §§ 157.23-157.25). But the only data bearing on such an obligation in this section of the regulations is an estimate of the first month's deliveries, which all parties concede will not necessarily apply to the second or any subsequent month. Failing again in this attempt, CFA turns to the data filed by the pipeline buyer (18 C.F.R. § 157.14). But the pipeline's source of supply comes from many producers in many fields, and its deliverability estimates are based on a composite of these sources. In short, the "certificate obligation" to produce specified quantities of gas to which CFA refers throughout its petition simply does not exist.

part of the producer to operate as an ordinary prudent operator. Producers have long recognized their obligation to develop and produce their leases in a diligent manner, and in accordance with what is described as the "ordinary prudent operator" test (see Appendix A, p. 19a). The state courts and conservation agencies, which developed this rule, are the proper forums for its enforcement. The question rather, is whether the Commission has been empowered under the Natural Gas Act to enforce this obligation. This question, the extent of the jurisdiction of the Commission over the producer's production activities, has long been settled by decisions of this Court.

REASONS FOR DENYING THE WRIT

This Court stated the objective of the Natural Gas Act in *Federal Power Commission v. Panhandle Eastern Pipe Line Company*, 337 U.S. 498, 513, as follows:

> "The Natural Gas Act was designed to supplement state power and to produce a harmonious and comprehensive regulation of the industry. Neither state nor federal regulatory body was to encroach upon the jurisdiction of the other. Congress enacted this Act after full consideration of the problems of production and distribution. It considered the state interests as well as the national interest. It had both producers and consumers in mind. Legislative adjustments were made to reconcile the conflicting views." (337 U.S. 498, 513) (nn. omitted)

This case follows other clear holdings by this Court. The Natural Gas Act was passed to fill the gap in regulation which the states could not reach, see *Panhandle Eastern Pipe Line Company v. Public Service Commission of Indiana*, 332 U.S. 507 (1947); *Public Utilities*

Commission v. Attelboro Steam & Electric Company, 273 U.S. 83 (1927); *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U.S. 498, 506-08 (1942); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 609-13 (1944), and *Interstate Natural Gas Co. v. Federal Power Commission*, 331 U.S. 682, 689-90 (1947).

In *Colorado Interstate Gas Co. v. Federal Power Commission*, 324 U.S. 581 (1945), after finding that the Commission could include production properties in the rate base of an interstate pipeline company, this Court stated:

> "That does not mean that the part of § 1(b) which provides that the Act shall not apply 'to the production or gathering of natural gas' is given no meaning. Certainly that provision precludes the Commission from any control over the activity of producing or gathering natural gas. For example, it makes plain that the Commission has no control over the drilling and spacing of wells and the like." (324 U.S. 581, at 602-03)

The Commission takes the position (p. 13) that this Court's opinion in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954) finding that the FPC had authority to regulate producer sales of natural gas in interstate commerce for resale operated to destroy the "production and gathering" exclusion of Section 1(b) of the Act. Contrary to the Commission's position, this Court clearly reiterated the distinction between transportation and sale and production and gathering, saying:

> "Similarly, in Colorado Interstate Gas Co. v. Federal Power Com. 324 US 581, 598, 89 L ed 1206, 1220,

> 65 S Ct 829, we stated that '[t]ransportation and sale do not include production or gathering,' and indicated that the 'production or gathering' exemption applies to the physical activities, facilities, and gathering of natural gas." (347 U.S. 672, at 678)[8]

This Court made its intent even clearer in *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965) as to the distinction between Commission's jurisdiction over the sale of gas in interstate commerce for resale and its lack of jurisdiction over the physical activity of production and gathering. This Court said:

> ". . . '[P]roduction or gathering' exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction. This accommodation of the two relevant clauses of § 1(b) gives content to the national objectives of the Natural Gas Act as expounded in Phillips, and to the Commission's jurisdiction to accomplish them, while in no way interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns." (381 U.S. 392, at 402-03)

This Court had previously sustained the validity of state conservation laws on the grounds that there jurisdiction over production did not interfere with interstate commerce as production was essentially a mining operation even though the product obtained was intended to be and was immediately shipped in interstate commerce, *Champlin Refining Co. v. Corporation Commission*, 286 U.S. 210, 235 (1931).

8. The Supreme Court did not disturb the Commission's finding that the production and gathering facilities were non-jurisdictional, *Phillips Petroleum Co.*, 10 F.P.C. 246 (1951).

Nor does *Sunray Mid-Continent Oil Co. v. Federal Power Commission*, 364 U.S. 137 (1960) hold otherwise. As noted by the Court of Appeals (Appendix A, p. 7a), this case, as well as *Sun Oil Co. v. Federal Power Commission*, 364 U.S. 170 (1960), merely hold that a producer who has wells fully capable of continuing production cannot discontinue deliveries in interstate commerce from those wells when his contract expires. This holding is a far cry from finding jurisdiction in the Commission to require the producer to drill additional wells or make additional capital expenditures to expand production, which is the authority claimed by the Commission under the Order below.

At the conclusion of its Opinion the Court of Appeals stated:

> "To hold that the power to issue Order No. 539-B is within the jurisdiction of the FERC would all but eliminate the 'production or gathering' exclusion and would allow the FERC to encroach on areas reserved to the states. We cannot so extend the authority of the Commission." (App. A, pp. 9a-10a) (n. omitted)

The Opinion of the Court of Appeals is correct and should be allowed to stand.

Respectfully submitted,

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